

Porto Energy Corp.
Consolidated Financial Statements

For the Three And Nine Month Periods Ended May 31, 2011 and 2010
(Unaudited)

(Stated in United States Dollars)

Porto Energy Corp.
Consolidated Balance Sheets
(Stated in United States dollars)
(unaudited)

	<u>May 31,</u> <u>2011</u>	<u>August 31,</u> <u>2010</u>
ASSETS		
Current assets:		
Cash	\$ 59,964,680	\$ 3,315,591
Accounts receivable	1,987,056	134,528
Prepaid expenses	275,268	210,392
Total current assets	<u>62,227,004</u>	<u>3,660,511</u>
Property and equipment (Note 6)	51,542,871	35,948,178
Restricted cash deposits (Note 8)	4,948,778	135,000
Total assets	<u>\$ 118,718,653</u>	<u>\$ 39,743,689</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,856,413	\$ 1,686,357
Related party payables (Note 10)	-	107,312
Total current liabilities	<u>1,856,413</u>	<u>1,793,669</u>
Asset retirement obligation (Note 7)	99,667	98,065
Future income tax liability	7,014,908	5,551,255
Total liabilities	<u>8,970,988</u>	<u>7,442,989</u>
Basis of presentation (Note 2)		
Commitments and contractual obligations and contingent liabilities (Notes 11 and 13)		
Subsequent events (Note 14)		
Shareholders' equity:		
Share capital (Note 9 (b))	107,729,031	29,557,450
Warrants (Note 9 (c))	2,906,356	822,566
Contributed surplus (Note 9 (g))	8,416,913	4,880,226
Deficit	<u>(9,304,635)</u>	<u>(2,959,542)</u>
Total shareholders' equity	<u>109,747,665</u>	<u>32,300,700</u>
Total liabilities and shareholders' equity	<u>\$ 118,718,653</u>	<u>\$ 39,743,689</u>

Approved by the Directors:

/s/ Patric Monteleone
 Director

/s/ Gerald Romanzin
 Director

The accompanying notes are an integral part of these financial statements.

Porto Energy Corp.
Consolidated Statement of Operations,
Comprehensive Income (Loss) and Deficit
(Stated in United States dollars)
(unaudited)

	Three Months Ended		Nine Months Ended	
	May 31,		May 31,	
	2011	2010	2011	2010
Revenues				
Other revenues	\$ 24,056	\$ 1,001	\$ 30,187	\$ 1,458
Expenses				
General and administrative	1,375,130	853,990	3,330,978	1,320,117
Professional fees	128,285	282,014	363,751	530,153
Interest expense	7,569	7,273	7,770	102,597
Stock based compensation (Note 9 (d))	963,548	-	1,951,693	-
Depletion, depreciation and accretion	9,095	3,799	16,956	12,294
Foreign exchange loss (gain)	(228,431)	209,811	(290,242)	297,340
Total Expenses	<u>2,255,196</u>	<u>1,356,887</u>	<u>5,380,906</u>	<u>2,262,501</u>
Net loss before income taxes and gain on settlement of debt	<u>(2,231,140)</u>	<u>(1,355,886)</u>	<u>(5,350,719)</u>	<u>(2,261,043)</u>
Future income taxes	63,910	210,400	1,463,653	688,952
Net loss before gain on settlement of debt	<u>(2,295,050)</u>	<u>(1,566,286)</u>	<u>(6,814,372)</u>	<u>(2,949,995)</u>
Gain (loss) on settlement of debt (Note 13)	-	(368,127)	469,279	6,188,440
Net income (loss) and comprehensive income (loss)	<u>(2,295,050)</u>	<u>(1,934,413)</u>	<u>(6,345,093)</u>	<u>3,238,445</u>
Retained earnings (deficit), beginning of period	(7,009,585)	196,031	(2,959,542)	(4,976,827)
Retained earnings (deficit), end of the period	<u>\$ (9,304,635)</u>	<u>\$ (1,738,382)</u>	<u>\$ (9,304,635)</u>	<u>\$ (1,738,382)</u>
Basic and diluted income (loss) per share	<u>\$ (0.01)</u>	<u>\$ (0.02)</u>	<u>\$ (0.05)</u>	<u>\$ 0.06</u>
Weighted average number of common shares outstanding - basic and diluted (Note 9 (f))	<u>177,200,047</u>	<u>92,086,643</u>	<u>134,733,286</u>	<u>57,421,228</u>

The accompanying notes are an integral part of these financial statements.

Porto Energy Corp.
Consolidated Statement of Cash Flows
(Stated in United States dollars)
(unaudited)

	Three Months Ended		Nine Months Ended	
	May 31,		May 31,	
	2011	2010	2011	2010
Cash Flows from Operating Activities				
Net income (loss)	\$ (2,295,050)	\$ (1,934,413)	\$ (6,345,093)	\$ 3,238,445
Items not affecting cash:				
Depletion, depreciation and accretion	9,095	3,799	16,956	12,294
Provision for future income taxes	63,910	210,400	1,463,653	688,952
Stock-based compensation	963,548	-	1,951,693	-
(Gain) loss on settlement of debt	-	368,127	(469,279)	(6,188,440)
Unrealized foreign exchange loss (gain)	80,267	209,812	18,456	297,340
	<u>(1,178,230)</u>	<u>(1,142,275)</u>	<u>(3,363,614)</u>	<u>(1,951,409)</u>
Net change in non-cash working capital items:				
Accounts receivable	(318,946)	8,981	(1,848,880)	35,982
Prepaid expenses	(230,764)	65,612	(64,876)	(16,133)
Related party payables	(63,141)	488,372	(107,312)	471,920
Accounts payable and accrued liabilities	(263,669)	(3,459)	359,462	169,624
Net cash used by operating activities	<u>(2,054,750)</u>	<u>(582,769)</u>	<u>(5,025,220)</u>	<u>(1,290,016)</u>
Cash Flows from Financing Activities				
Shares and warrants issued for cash	71,406,751	5,805,000	89,002,564	7,790,000
Shares issue costs paid in cash	(5,279,130)	(323,594)	(7,255,821)	(472,280)
Repayments of notes payable	-	(15,682)	-	(73,700)
Repayments of related party notes payable	-	(141,527)	-	(165,251)
Net cash provided by financing activities	<u>66,127,621</u>	<u>5,324,197</u>	<u>81,746,743</u>	<u>7,078,769</u>
Cash Flows from Investing Activities				
Acquisition of property and equipment	(4,981,849)	(351,030)	(15,613,695)	(1,502,932)
Loan from Porto pre-amalgamation	-	-	-	3,583,435
Cash received on amalgamation	-	-	-	412,834
Restricted cash deposits	(4,813,777)	(60,000)	(4,808,061)	(60,000)
Net change in non-working capital - accounts payable and accrued liabilities	(751,565)	(201,575)	362,667	(1,971,785)
Net cash used by/(used by) investing activities	<u>(10,547,191)</u>	<u>(612,605)</u>	<u>(20,059,089)</u>	<u>461,552</u>
Foreign exchange gain (loss) on cash held in a foreign currency	-	(602)	(13,345)	1,642
	<u>-</u>	<u>(602)</u>	<u>(13,345)</u>	<u>1,642</u>
Net increase in cash	53,525,680	4,128,221	56,649,089	6,251,947
Cash at beginning of the period	6,439,000	2,169,236	3,315,591	45,510
Cash at end of the period	<u>\$ 59,964,680</u>	<u>\$ 6,297,457</u>	<u>\$ 59,964,680</u>	<u>\$ 6,297,457</u>
Supplemental disclosure of cash flow information				
Interest Paid	\$ 7,569	\$ 36,735	\$ 7,770	\$ 65,953
Interest Received	24,057	1,002	30,158	1,403
Cash Paid for Income Taxes	(7,484)	-	60,000	-
Non-cash financing activities				
Fair value of warrants issued	\$ -	\$ -	\$ 3,553,204	\$ -
Shares Issued for Accounts Payable	101,250	(192,691)	101,250	3,852,290
Shares issued for related Party Notes	-	-	-	564,413
Shares issued for related Party Payables	-	-	-	525,621
Shares issued for Net Profit Interest ("NPI")	-	-	-	885,235

The accompanying notes are an integral part of these financial statements

Porto Energy Corp.
Notes to the Consolidated Financial Statements
For the Three and Nine Month Periods Ended May 31, 2011 and 2010
(Stated in United States dollars)
(unaudited)

1. DESCRIPTION OF BUSINESS

Porto Energy Corp., a development stage company (the “Company”), was formed through the amalgamation (the “Amalgamation”) of Porto Energy Corp. (“Porto”) and Mohave Exploration & Production Inc. (“MEPI”) pursuant to the provisions of the *Business Corporations Act* (British Columbia) on January 30, 2010.

The Company, through the amalgamation of MEPI, owns 100% of the common shares of Mohave Oil and Gas Corporation (“Mohave”) and Mohave’s wholly owned subsidiary, Mohave Portugal Corporation (“Portco”), both Texas incorporated entities.

The Company’s primary operating activities are carried out through Mohave which owns ownership positions in the Aljubarrota-3, Torres Vedras-3, Sao Pedro de Muel-2, Cabo Mondego-2, and Rio Maior-2 oil and gas concessions in Portugal (the “Portugal Assets”). The Company is undertaking exploration and development operations in respect of these concessions.

2. BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. The Company has not yet realized profitable operations, has relied on non-operational sources of financing to fund operations, and has incurred ongoing annual deficits.

The unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and include the accounts of the Company and its wholly owned subsidiaries and branches. All intercompany balances and transactions have been eliminated. All amounts are stated in United States dollars, unless otherwise noted by C\$ for Canadian dollars or € for Euros.

3. SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and the notes thereto in the Company’s Annual Consolidated Financial Statements for the year ended August 31, 2010. Certain information and disclosures normally required to be included in notes to annual consolidated financial statements have been condensed or omitted from these interim financial statements.

The accounting policies applied by the Company in these unaudited consolidated financial statements are the same as those applied by the Company in its audited consolidated financial statements for the year ended August 31, 2010.

In February 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed that Canadian publically accountable enterprises would be required to adopt International Financial Reporting Standards (“IFRS”) for the fiscal years beginning on or after January 1, 2011. IFRS uses a conceptual framework similar to Generally Accepted Accounting Principles (“GAAP”), but there are differences in recognition, measurement and disclosures.

4. FINANCIAL INSTRUMENTS

The Company is exposed to various risks that arise from its business environment and the financial instruments it holds. The following outlines the Company's risk exposures, quantifies these risks, and explains how these risks and its capital structure are managed.

The Company categorized its financial instruments carried at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. At May 31, 2011, the Company valued cash and restricted cash deposits using Level 1 inputs and it did not have any assets and liabilities measured at fair value using Level 2 and 3 inputs.

Levels 1, 2 and 3 are defined as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

Financial instruments are recognized initially at fair value on the balance sheet, and include cash, accounts receivable, restricted cash deposits, accounts payable and accrued liabilities and related party payables. The Company has classified its cash and restricted cash deposits as held for trading; accounts receivable is classified as loans and receivables; and accounts payable and accrued liabilities and due from related parties is classified as other liabilities. Held for trading instruments are measured at fair value, while loans and receivables and other liabilities are initially recognized at fair value and subsequently measured at amortized cost.

Credit risk

The Company is exposed to credit risk in relation to its cash, accounts receivable and restricted cash deposits. The cash and restricted cash deposits are held with highly rated Canadian and United States banks. Therefore, the Company considers these assets to have negligible credit risk.

The Company's accounts receivable are primarily with local and federal government agencies pertaining to the refund of excise taxes paid on certain expenditures. Also included in accounts receivable are amounts due from joint venture partners which are primarily junior oil and gas partners. Its overall exposure to credit risk from joint venture partners is considered to be low given during the nine months ended May 31, 2011, and the year ended August 31, 2010, the Company acquired the interests in the properties held by two of its three joint venture partners including any related outstanding receivables.

The carrying amounts of cash, accounts receivable, and restricted cash deposits represent the Company's maximum credit exposure. The Company does not have an allowance for doubtful accounts at May 31, 2011 or August 31, 2010.

Liquidity risk

The Company manages the risk of not meeting its financial obligations through management of its capital, annual budgeting of its expenditures and cash flows and cash flow forecasting.

Accounts payable and accrued liabilities and related party payables as disclosed on the consolidated balance sheet, fall due within the next year and are anticipated to be funded with current cash on hand or balances. The Company has no access to any further debt or debt facility.

Market risk

Changes in commodity prices, interest rates and foreign currency exchange rates can expose the Company to fluctuations in its net loss and in the fair value of its financial assets and liabilities.

Commodity price risk

Price fluctuations for crude oil, natural gas liquids and natural gas are a risk to the Company over which the Company has little influence. The Company is in the development stage and does not have any production. As a result, the commodity price risk is low.

Interest rate risk

The Company had no debt instruments or marketable securities outstanding at May 31, 2011. The interest risk on the cash balance is low due to depressed interest rates.

Foreign currency exchange rate risk

Substantially all of the Company's operations are conducted in a foreign jurisdiction, so the Company is exposed to foreign currency exchange rate risk. Operating and capital expenditures are incurred in United States dollars, Canadian dollars (C\$) and in Euros (€). Most of its contractors and activities are denominated and reported in United States dollars. However, our current drilling contract as well as one seismic contract are denominated in Euros along with various other smaller contracts. The Company manages its exposure primarily by balancing monetary assets and liabilities and maintaining cash positions in foreign currencies only at levels necessary for operating purposes. As of May 31, 2011, May 31, 2010, and August 31, 2010, the Company considers its foreign currency exchange rate risk to be moderate but the impact is considered to be immaterial.

5. CAPITAL MANAGEMENT

The Company's objective is to maintain a strong capital position in order to execute its business plans and maximize value to shareholders. The Company defines its capital as shareholders' equity and working capital deficit. Changes to the capital structure are driven by the Company's business plans, changes in economic conditions and risks inherent in the global oil and gas industry. During the year ended August 31, 2010, there were material changes to the capital structure due to the settlement of the Company's working capital deficiencies accumulated during the years ended August 31, 2009 and 2008. Methods to adjust the Company's capital structure in the future could include issue of new shares through a public offering or private placement (Note 9(b)), restructuring or repaying existing accounts payable, notes payable and related party notes payable (Note 10) and amalgamation with industry partners Note 9(b)).

The shareholders' equity and working capital deficit for the respective periods were as follows:

	May 31, 2011	August 31, 2010
Working capital deficit	N/A	N/A
Shareholders' equity	109,747,665	32,300,700
	<u>\$ 109,747,665</u>	<u>\$ 32,300,700</u>

The Company periodically reviews certain quantitative measures of its capital structure, in order to understand its position relative to industry peers. These measures include calculations such as return on equity and return on capital employed. The Company does not set certain limits or ranges with respect to these quantitative measures.

6. PROPERTY AND EQUIPMENT

	As of May 31, 2011		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Oil and gas assets	\$ 51,436,351	\$ -	\$ 51,436,351
Furniture and equipment	189,453	82,933	106,520
Property and equipment	<u>\$ 51,625,804</u>	<u>\$ 82,933</u>	<u>\$ 51,542,871</u>

	As of August 31, 2010		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Oil and gas assets	\$ 35,914,823	\$ -	\$ 35,914,823
Furniture and equipment	100,934	67,579	33,355
Property and equipment	<u>\$ 36,015,757</u>	<u>\$ 67,579</u>	<u>\$ 35,948,178</u>

The Company is in the development stage and as a result all oil and gas property expenditures are considered to be unproven and all costs are in one cost center, Portugal. Management has assessed that the carrying value of these properties is not impaired as at May 31, 2011 and August 31, 2010. Approximately \$57,900 and \$146,960 was capitalized from general and administrative expense and no interest expense was capitalized during the three and nine months ended May 31, 2011. No amounts were capitalized from general and administrative expense and no interest was capitalized as at August, 31, 2010.

In August 2010, the Company, through its wholly-owned subsidiary, entered into an agreement to acquire 3-D seismic in the Torres Vedras-3 and Aljubarrota-3 concessions. During the three and nine months ended May 31, 2011, the Company incurred \$2.3 million and \$11.6 million, respectively, in associated cost to obtain permits to conduct the seismic work and to survey and record approximately 120 sq km 3-D seismic in the Company's Torres Vedras-3 and Aljubarrota-3 concessions, which began in November 2010.

The Company incurred an additional \$2.6 million and \$3.9 million in capital costs associated with leaseholds, furniture and fixtures, plug and abandonment charges and drilling costs primarily related to the Torres Vedras-3 concession and the Aljubarrota-3 concession during the three and nine months ended May 31, 2011, respectively.

During the three and nine months ended May 31, 2010, the Company acquired the interests in the properties held by two of its three joint venture partners on its oil and gas properties in Portugal. The purchase price and assumption of all related outstanding joint venture receivable were recorded as part of the acquisition of oil and gas assets in property and equipment during the nine months ended May 31, 2010.

The Company's ability to realize the balance of the capitalized value of its oil and gas properties is dependent on the Company obtaining additional financing sufficient to develop the oil and gas projects and the successful development of those projects.

7. ASSET RETIREMENT OBLIGATION

The following table provides a reconciliation of the carrying amount of the obligation associated with the retirement of oil and gas properties ("ARO") as at May 31, 2011 and August 31, 2010:

ARO as of August 31, 2009	\$ 92,184
Liabilities incurred during the year	-
Accretion expense	5,881
Revisions in estimates during the year	-
ARO as of August 31, 2010	<u>\$ 98,065</u>
Liabilities incurred during the period	-
Accretion expense	1,602
Revisions in estimates during the period	-
ARO as of May 31, 2011	<u>\$ 99,667</u>

The key assumptions, on which the carrying amount of the asset retirement obligation is based, include a credit-adjusted risk-free rate of 7.50% and an inflation rate of 2.50%. The total, undiscounted amount of the estimated cash flow to settle the obligations at May 31, 2011 and August 31, 2010 is \$112,000. The expected timing of the cash outflow required to settle the obligations is 6 to 9 years hence.

8. RESTRICTED CASH DEPOSITS

As of May 31, 2011 and August 31, 2010, the Company had restricted cash deposits held by U.S. banks of \$4,948,778 and \$135,000, respectively, primarily related to standby letters of credit for its properties in Portugal to insure certain performance obligations and commitments under the concessions.

All standby letters of credit are held in U.S. or German banks and their terms are governed by the corresponding concession agreements and under customary lending practices.

9. SHARE CAPITAL

(a) Authorized

Unlimited number of common shares.

(b) **Issued
Common Shares**

Mohave Exploration and Production Inc.	Number of Shares	Amount
Balance, August 31, 2009	30,365,128	\$ 12,778,572
Shares issued for debt	8,503,816	2,296,761
Shares issued for purchase of net profit interests	4,426,173	885,235
Balance, January 30, 2010	43,295,117	\$ 15,960,568
 Porto Energy Corp.		
Shares issued on Amalgamation with MEPI	43,295,117	\$ 15,960,568
Shares issued to acquire Porto Energy Corp.	32,800,000	3,881,682
Shares issued for cash	15,580,000	6,967,524
Shares issued for debt	7,343,103	3,219,956
Share issue costs		
Brokers fees paid in cash	-	(472,280)
Broker fees paid in shares	33,500	-
Balance, August 31, 2010	99,051,720	\$ 29,557,450
Shares issued for cash	99,326,683	\$ 88,897,814
Share issue cost	-	(7,255,821)
Value of warrants issued with private placement	-	(3,553,204)
Value of brokers warrants issued with private placement	-	(123,208)
Warrants exercised	209,500	104,750
Shares issued for debt	101,250	101,250
Balance, May 31, 2011	198,689,153	\$ 107,729,031

For the fiscal year ended August 31, 2010:

The Company was formed through the Amalgamation of Porto and MEPI pursuant to the provisions of the Business Corporations Act (British Columbia) on January 30, 2010. Pursuant to the Amalgamation, each MEPI Class A common shareholder received 0.57425 of a Company common share for each MEPI Class A common share held, each MEPI Class B common shareholder received one Company common share for each MEPI Class B common share held and each Porto common shareholder received one Company common share for each Porto common share held. The MEPI and Porto options and warrants were exchanged for options or warrants of the Company using the same exchange ratios. All share and per share amounts in these financial statements have been adjusted to give retroactive effect to the exchange ratio of the Amalgamation.

For the nine months ended May 31, 2011:

In December 2010, the Company completed a private placement of 29,326,683 units at a price of \$0.60 per unit for gross proceeds of approximately \$17,596,000. Each Unit consists of one common share; one common share purchase warrant; one Common Share liquidity warrant (a "Liquidity Warrant"); and one Common Share anti-dilution warrant (an "Anti-dilution Warrant").

Each common share purchase warrant will entitle the holder to acquire one common share at the subscription price of \$0.85 during the 24 months following the closing date of a Liquidity Event defined as (i) an initial public offering ("IPO") and listing of the Common Shares on a recognized stock exchange with a minimum offering size of \$40,000,000; or (ii) a reverse-takeover transaction that results in the listing of the Common Shares on a recognized stock exchange. Each Liquidity Warrant will be

exercisable by the holder thereof, at no additional cost, into common shares equal to 10% of the nominal number of Liquidity Warrants at 6, 12 and 18 months from December 3, 2010, if a Liquidity Event has not closed on or prior to such date. The Liquidity Warrants expire upon the completion of a Liquidity Event. As a result, they expired unexercised on March 29, 2011.

The Anti-dilution Warrants expire on the date that is the earlier of: (i) the date on which the Company completes one or more equity financings (by private placement, prospectus or otherwise) for not less than an aggregate of \$40,000,000 at a share price equal to or greater than \$0.60 per common share; and (ii) December 31, 2012. The Anti-dilution Warrants are also exercisable at no additional cost into common shares if an offering is entered into for less than \$0.60 per common share. They expired unexercised on March 29, 2011.

In conjunction with this placement, 1,559,600 broker warrants were issued, exercisable at a price of \$0.85 per common share for a period of 24 months from the closing date of the private placement and approximately \$1,136,000 was paid in finders' fees and charged to share issue costs. During the nine months ended May 31, 2011, the Company incurred approximately \$1,895,485 in issuance costs as part of the Company's marketing efforts and this was recorded against the offering proceeds in share capital.

Under the terms of an agency agreement dated March 15, 2011, the Company qualified the sale and distribution of 70,000,000 common shares at a price of C\$1.00 per common share on March 29, 2011. The gross proceeds received by the Company were approximately C\$70,000,000, before deducting issue expenses and agents' fees in the aggregate totaling approximately C\$4,370,000. This issuance qualified as a "liquidity event" under the terms of the private placement agreement in December of 2010. As a result, the Liquidity Warrants and the Anti-dilution Warrants associated with the private placement expired unexercised.

(c) Warrants

The fair value of share purchase warrants issued as part of private placements has been estimated using the Black-Scholes option-pricing model (see assumptions in Note 9(e)) and recorded as a reduction of the gross proceeds on placement and credited to share purchase warrants.

	Number of Warrants	Amount	Average Exercise price
Balance, August 31, 2009	8,326,426	\$ 3,608,768	C\$ 1.31
Warrants assumed on amalgamation	9,750,000	-	\$ 0.50
Value of warrants issued with private placement	7,790,000	822,476	\$ 1.00
Expired warrants	(8,326,254)	(3,608,678)	C\$ 0.31
Balance, August 31, 2010	<u>17,540,172</u>	<u>\$ 822,566</u>	<u>\$ 0.72</u>
Value of warrants issued with private placement	29,326,683	2,083,890	\$ 0.85
Value of Anti-dilution warrants	29,326,683	738,299	-
Value of Liquidity warrants	29,326,683	731,015	-
Expired warrants	(58,653,538)	(1,469,414)	-
Warrants exercised	(209,500)	-	\$ 0.50
Balance, May 31, 2011	<u>46,657,183</u>	<u>\$ 2,906,356</u>	<u>\$ 0.81</u>

The outstanding Warrants as at May 31, 2011 are as follows:

Series	Number of Warrants	Exercise Price	Expiry date
December, 2009	9,540,500	\$ 0.50	March 29, 2012
February, 2010	1,985,000	\$ 1.00	March 29, 2012
April, 2010	5,805,000	\$ 1.00	March 29, 2012
December, 2010	29,326,683	\$ 0.85	March 29, 2013
	<u>46,657,183</u> *		

* This amount does not include 1,559,600 broker warrants associated with the December 2010 private placement.

(d) Employee Options

A summary of employee option activity is as follows:

	Number of Options	Exercise Price
Outstanding, end of year August 31, 2009	1,105,426	C\$ 1.31
Options Issued	-	-
Options exercised	-	-
Options forfeited	(307,218)	C\$ 1.31
Outstanding, end of year August 31, 2010	<u>798,208</u>	<u>C\$ 1.31</u>
Options Issued	11,600,000	\$ 0.60
Options exercised	-	-
Options forfeited	(1,548,208)	C\$ 1.31
Outstanding, at May 31, 2011	<u>10,850,000</u>	<u>\$ 0.60</u>

On October 30, 2007, the Board of Directors approved a Stock Option Plan. The plan was subsequently amended in December 2010 to better conform to industry standards and practices such as, but not limited to, repricing guidelines, employee qualifications and other jurisdictional participation issues. This plan is subject to shareholder approval. It provides for a 5 year term with vesting requirements to be set by the Board of Directors. The aggregate number of common shares subject to options granted under the Stock Option Plan, from time to time, cannot exceed 10% of the common shares outstanding after giving effect to the issuance of the options.

During the nine months ended May 31, 2011, in accordance with the Company's Long-Term Incentive Plan, the Board of Directors granted 11,600,000 options to acquire common shares to its directors, officers, employees and consultants to purchase common shares at a strike price of \$0.60 per share. The options are set to expire on September 1, 2015 and generally one-third will vest on September 1, 2011, one-third on March 1, 2012 and the remaining one-third on September 1, 2012. As part of that grant, previously issued stock options were required to be surrendered and cancelled. A fair value of approximately \$0.397 per share was assigned to the options based on the Black-Scholes model with assumptions as outlined below. During the three and nine months ended May 31, 2011, the Company recognized \$963,548 and \$1,951,693, respectively, in stock compensation expense. Additionally, 1,548,208 options were forfeited due to the Company's reorganization efforts during the three months ended May 31, 2011. There was no stock compensation expense recognized during the three and nine months ended May 31, 2010.

(e) **Black-Scholes Assumptions**

Assumptions used in the fair value calculation of warrants and employee options, include:

	Nine Months Ended May 31, 2011	Year Ended August 31, 2010
Expected life	1-3 years	1.25 years
Expected volatility	107%-110%	86-113%
Average risk-free interest rate	1.64%-1.70%	1.14-1.96%
Expected dividends	Nil	Nil

(f) **Per Share Amounts**

For the three and nine months ended May 31, 2011, there were 177,200,047 and 134,733,286 weighted average common shares outstanding, respectively. For the three and nine months ended May 31, 2010, there were 92,086,643 and 57,421,228 weighted average common shares outstanding, respectively. The weighted average number of common shares outstanding was not increased for outstanding warrants or options for purposes of calculating diluted shares outstanding for the three and nine months periods ended May 31, 2011 and 2010, as the effect would be anti-dilutive.

(g) **Contributed Surplus**

	Amount
Outstanding at year-ended August 31, 2009	\$ 1,271,549
Expired warrants	3,608,677
Outstanding, year-ended August 31, 2010	4,880,226
Stock based compensation	1,951,693
Fair value of agent warrants issued	123,208
Expired warrants	1,469,314
Other	(7,528)
Outstanding at May 31, 2011	<u>\$ 8,416,913</u>

10. RELATED PARTY TRANSACTIONS

Unless otherwise disclosed elsewhere in these consolidated financial statements, the related party transactions are as follows:

- (a) Included in related party payables as at May 31, 2011 is \$nil (August 31, 2010 - \$107,000) in unpaid out of pocket expenses to the Company's Executive Vice President. During the nine months ended May 31, 2011, all outstanding amounts owed to the Executive Vice President were paid in full.
- (b) The Company has retained a law firm to provide it with legal services where a director and an officer of the Company are partners of this law firm. Legal fees were incurred by the Company to the law firm for the three and nine month periods ended May 31, 2011 of \$29,309 and \$474,874, respectively. During the same periods ended 2010, fees were incurred by the Company of \$150,000 and \$207,000, respectively, to the same law firm. Included in accounts payable and accrued liabilities as at May 31, 2011 is \$23,723 (August 31, 2010 - \$60,000).

- (c) During the three and nine month periods ended May 31, 2011, the Company recorded \$3,455 and \$38,455, respectively in rent expense for the use of office space and furniture and equipment to corporations with common officers and directors. For the corresponding periods ended 2010, \$nil and \$4,724, respectively, in rent expense was incurred from the same common officers and directors. Included in accounts payable and accrued liabilities at May 31, 2011 is \$477 (August 31, 2010 - \$514).
- (d) During the three and nine month periods ended May 31, 2011, the Company incurred \$nil in consulting fees and salary directly or to a private company controlled by a former director of the Company. For the corresponding periods in 2010, \$nil and \$30,234, respectively, were incurred for fees and salaries to the same private company. There are no outstanding balances related to these service fees and salary at May 31, 2011 or at August 31, 2010.
- (e) During both the three and nine month periods ended May 31, 2011, the Company recorded \$nil as consulting fees payable to a company owned by the former Chief Financial Officer. For the corresponding periods in 2010, \$nil and \$3,778, respectively, were incurred and recorded as consulting fees payable to the same company. There were no outstanding balances related to these consulting fees included in related party payables as at May 31, 2011 or August 31, 2010.

Transactions (a) through (e) are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

11. COMMITMENTS AND CONTRACTUAL OBLIGATIONS

- (a) On August 3, 2007 the Company executed five concessions contracts with the Ministry of the Industry and Innovation for petroleum exploration, development and productions rights in Portugal (the “Ministry”). The contracts provide for an initial eight year term with 2 one year extensions and a twenty-five year production period based on an approved development and production plan with a 15 year production period extension. For each of the concessions: Torres Vedras-3, Aljubarrota-3, Cabo Mondego-2, Rio Major-2 and Sao Pedro de Muel-2; the Company is committed to drill either six or seven wells with an estimated expenditure of €500,000 for well work. The minimum total contract commitment is €15.0 million starting in 2008 and expiring in 2015.

Each concession requires the Company to post an initial bond, in favour of Ministério da Economia e da Inovação - Direcção-Geral de Energia e Geologia, (“DGEG”), the regulating agency for petroleum exploration and production in Portugal, to guarantee future performance and commitments under the concession agreement upon the issuance and/or signing of the concession contract. In relation to the Company’s 2011 work program commitments, the Company posted a \$2.0 million work program bond with a third party bank in favor of DGEG.

- (b) On April 4, 2011, the Company entered into a drilling contract with KCA Deutag drilling GmbH. The term of the contract is for one year with a one year extension option under the same terms and has an estimated contract value of approximately €8.0 million. Additionally, the contract required a bank guarantee of €1.8 million to be placed. The Company placed the guarantee in April, 2011 with a third party bank.
- (c) As of May 31, 2011 and August 31, 2010, the Company had approximately \$4,948,778 and \$135,000, respectively, in standby letters of credit associated with the guarantees discussed in Note 10(a) and Note 10(b) and are recorded as restricted cash deposits.
- (d) In the normal course of operations, the Company provides indemnifications that are often standard contractual terms to counterparties in transactions such as purchase and sale contracts, service agreements, director/officer contracts and leasing transactions. These indemnification agreements may require the

Company to compensate the counterparties for costs incurred as a result of various events, changes in (or in the interpretation of) laws and regulations, or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnification agreements will vary based upon the contract, the nature of which prevents the Company from making a reasonable estimate of the maximum potential amount that could be required to be paid to counterparties. Historically, the Company has not made any significant payments under such indemnifications and no amounts have been accrued in the accompanying consolidated financial statements with respect to these indemnification guarantees.

See Subsequent Events (Note 14) for additional information concerning commitments and contractual obligations.

12. INCOME TAXES

For the three and nine months ended May 31, 2011, the Company recognized future income tax expense of \$63,910 and \$1,463,653 on a net loss before income tax of \$2,231,140 and \$5,350,719, respectively. During the corresponding periods ended 2010, the Company recorded future income tax expense of \$210,400 and \$688,952, respectively, on a net loss before income tax of \$1,355,886 and \$2,261,043, respectively. The difference between the effective tax rate recognized and the blended statutory rates of its various taxing jurisdictions in which the Company operates is primarily due to it applying a valuation allowance for the full amount of its gross future tax asset as it believes, based on the weight of available evidence, that it is more likely than not that the future tax asset will not be realized prior to the expiration of net operating loss carryforwards in various amounts at 2028 through 2031. Net operating loss carryforwards as of May 31, 2011, were approximately \$24.5 million.

13. CONTINGENT LIABILITIES

For the three and nine month periods ended May 31, 2011:

Pursuant to a debt settlement agreement dated December 21, 2009, the Company provided certain anti-dilution rights to the Company's former largest creditor such that the creditor's ownership of the Company cannot be less than 6% just prior to closing of an IPO and whose deemed value shall not be less than \$3.0 million at the IPO price per share. As at August 31, 2010, the creditor had been issued 5,943,103 of the Company's common shares in order to comply with the requirements in the debt settlement agreement. During the nine months ended May 31, 2011, the Company terminated anti-dilution rights. In conjunction with the termination, the Company bought casing and existing drilling inventory for \$850,000 from the third party.

Pursuant to a debt settlement agreement dated December 24, 2009, the Company provided certain anti-dilution rights to the Company's former second largest creditor such the deemed value of their 1,400,000 common shares shall not be less than \$700,000 at the IPO price per share. The creditor also has the right to put the 1,400,000 common shares of the Company to the Company for \$450,000 should the IPO not be closed by November 1, 2010. During the quarter ended February 28, 2011, the anti-dilution rights, including the right to put 1,400,000 common shares of the Company for \$450,000, were terminated. As a result, the Company recorded a gain on the settlement of debt of \$469,279 after translation adjustments.

For the three and nine month periods ended May 31, 2010:

During the nine months ended May 31, 2010, the Company entered into debt settlement agreements for conversion of \$5,135,015 debt in exchange for issuing 15,083,514 common shares, including 5,686,255 common shares issued to related parties. These transactions were settled by the issuance of 8,503,816 common shares for settlement of \$2,296,761 debt prior to the Amalgamation and issuance of 6,579,698 common shares

for settlement of \$2,838,254 debt subsequent to the Amalgamation. As a net result of the debt settlement in shares and cash, (\$368,127) and \$6,188,440 was recorded as a gain on the settlement of debt in the statement of operations for the three and nine month periods ended May 31, 2010, respectively.

14. SUBSEQUENT EVENTS

Subsequent to the period ended May 31, 2011:

In June 2011, the Company, through its wholly-owned subsidiary, entered into an agreement to acquire 3-D seismic over approximately 240 km² over the Montejunto Anticline in its Torres Vedras-3 concession onshore Portugal. The term of the contract is from August 15, 2011 to December 15, 2011 and has an estimated contract value of approximately €6.65 million.

In June 2011, the Company, through its wholly-owned subsidiary, entered into an agreement to acquire approximately 1,000 km² of 3-D seismic in its Sao Pedro de Muel-2 and Cabo Mondego-2 concessions offshore Portugal. The term of the contract is from mobilization of the Contractor Group Field Unit and personnel to the survey area to the demobilization of the Contractor Group Field Unit and personnel to a location mutually agreed to between the parties and has an estimated contract value of approximately \$10.0 million, with \$5.0 million paid in advance of mobilizing the Contractor's vessel.